Summary for non-specialists
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Post-Programme Surveillance for Ireland

Spring 2014 Report

This paper discusses the main findings of the first post-programme surveillance (PPS) review for Ireland. Staff from the European Commission (EC), in liaison with the European Central Bank (ECB), undertook the first PPS review for Ireland from 29 April to 2 May 2014. The mission was coordinated with the IMF's post-programme monitoring mission. The report gives an overview of the main findings of the mission and of the challenges faced by Ireland.

Overall, the positive trends of economic adjustment observed during the EU-IMF financial assistance programme have continued against the backdrop of an improving external environment and buoyant international financial markets. Further progress is required in several areas to complete the adjustment process and to achieve balanced and sustainable growth. In particular, in view of still very high government and private indebtedness, coupled with a large stock of impaired assets in the domestically owned banks, Ireland needs to continue with fiscal consolidation, reduce the private sector debt overhang, and further progress with financial sector repair to safeguard and strengthen the economic recovery.

While economic growth turned out lower than expected in 2013, the outlook for 2014 and 2015 is improving. At -0.3% real GDP growth was below expectations in 2013, and at odds with other economic indicators, especially employment. High-frequency indicators continue to point to a solid recovery in 2014. In the first few months of the year, unemployment remained on a downward path, reaching 11.8% in April, and property market prices are picking up, though the highly leveraged private and public sectors inhibit a faster recovery, especially of private consumption. The EC projects GDP growth to rise to 1.7% in 2014 and 3% in 2015. Inflation is expected to remain muted.

Fiscal consolidation remains on course though political pressures on the budget are increasing. The general government deficit narrowed by 1 percentage point of GDP in 2013 to 7.2% of GDP, below the Excessive Deficit Procedure (EDP) ceiling of 7.5% of GDP. Overall, expenditure developments were on track, while some overruns in the health sector (0.1% of GDP) were offset by savings in other areas. Barring surprises, the 2014 fiscal deficits target under the EDP will likely be met despite some slippages in the health sector. The government remains committed to sustainably correct the excessive deficit by 2015 and achieve a balanced budget by 2018. Measures needed to meet the 2015 EDP target of 2.9% of GDP have not been detailed and are expected to be announced in October with the draft budget.

Though still susceptible, the financial sector continues to recover. The three main domestic banks' performance continues to improve. The banks' capital ratios are above the regulatory minimum and though non-performing loans (NPLs) remain very elevated, provision for their coverage are relatively high. Two of three banks, Allied Irish Bank and Bank of Ireland, returned to profitability in early 2014, and have now had state aid restructuring plans approved by the EC. Both mortgage and commercial loan restructuring can take multiple years, thus it will take some time for high level of NPLs to fall significantly. The Central Bank of Ireland (CBI) is undertaking the relevant work for the ECB's comprehensive assessment (CA) of the banks, and the results will be communicated in November 2014.

Financing initiatives to boost growth and SMEs are welcome but careful planning is required to make them sustainable. Plans have been outlined for the establishment of the Strategic Banking Corporation of Ireland (SBCI) to boost SME lending. The establishment of the Irish Strategic Investment Fund (ISIF), due to replace the NPRF, will need cautious oversight. The new fund will amount to 4% of GDP and involve private co-funding of Irish firms. ISIF will have a double objective of raising jobs and growth, while also generating a commercial return. It will also focus on SMEs and infrastructure investment. To boost investment in new housing, the government is studying the introduction of a mortgage insurance scheme for first-time buyers of new homes. While details are still lacking, it will be crucial to prevent potential effects on house prices and possible contingent liabilities for the state.

Structural reforms continue to progress and aim to support fiscal consolidation, improvements in the labour market and competition in sheltered sectors. Water charges will be introduced in the final quarter of 2014 with a positive impact on public finances, and the water sector reforms are proceeding. The implementation of the Legal Services Regulation Bill has slipped again and renewed momentum is needed for its enactment during the third quarter and the establishment of the regulatory authority by the end of 2014. Active labour market policy reforms continue while further education and training measures are at a much earlier stage. These need to be geared to satisfying jobseekers' and employers' needs, while helping get the long-term unemployed back to work. The key health sector reforms are proceeding, but important steps are still to be taken. The sale of state assets has progressed in recent months with the sale of Bord Gáis Energy and two power plants of the Electricity Supply Board. Proceeds from these asset sales could yield up to EUR 500 million (about 0.3% of GDP) in 2014 in government revenue.